



# RESERVE FORCES POLICY BOARD

## **Eliminating Major Gaps in DoD Data on the Fully-Burdened and Life-Cycle Cost of Military Personnel: Cost Elements Should be Mandated by Policy**

**Final Report to the Secretary of Defense**

**January 7, 2013**

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## EXECUTIVE SUMMARY

It is increasingly apparent and documented by and to senior Department of Defense (DoD) and Congressional leaders, outside think tanks and subject matter experts, that the fully-burdened and life-cycle cost growth trends supporting the All-Volunteer force have reached unsustainable levels. Although the Department requires its contractors to provide fully-burdened and life-cycle cost computations on their invoices and the Department's acquisition process require the same before approving the purchase of major weapon systems, The Reserve Forces Policy Board (RFPB) found that the Department does not know, use, or track the fully-burdened and life-cycle costs of its most expensive resource – its military personnel. Thus, major military manpower decisions are uninformed on the real present and future costs. The RFPB concluded that the Department suffers from a gap in its costing data, because it lacks proper policy to require a complete and consistent costing methodology that can identify the true fully-burdened and life-cycle costs. Consequently, in this report, the Board recommends the establishment of such policies and proposes specific cost elements that should be included in them.

In our interim report to the Secretary of Defense in June 2012, the RFPB noted that senior leaders within DoD do not have complete or uniform data on the total costs of Active and Reserve Component forces. This conclusion was based on several discussions with senior DoD leaders, military and civilian, who believed that Reserve Component (RC) members are more expensive than their Active Component (AC) counterparts. Those remarks and subsequent analysis indicated that there is a gap in the data provided to DoD leadership. As a result, decisions about military personnel as well as the optimal mix of Active and Reserve Component forces are not fully informed. Consequently, the Reserve Forces Policy Board (RFPB) recommended the establishment of appropriate DoD policy guidance to accurately and consistently capture the costs of both components in order to fill this data gap. The Board concluded that knowing the fully-burdened costs of each component (active, reserve, civilian and contractor) is foundational for senior DoD decision makers as they develop Courses of Action (COAs) and make assessments and decisions on future force mix options.

Also included in the June interim report was the observation that there have been many studies done in the past on component costing, but there is no consistency in identifying which costing elements should be included or how costing elements are used or counted when making comparisons. The RFPB recommended that DoD establish a policy to address this gap. Subsequently, the Deputy Director of Cost Assessment and Program Evaluation (CAPE) committed to address this gap and agreed to work on writing a policy to meet the need. The RFPB applauds the willingness of CAPE to pursue this objective.

Following the issuance of the interim report, the RFPB project team conducted additional quantitative fiscal analysis and met with a wide range of subject matter experts inside and outside of the Department of Defense. These discussions included personnel from each of the Services, the offices of Cost Assessment and Program Evaluation, Comptroller, Defense Human Resources Activity Office of Actuary, the Assistant Secretary of Defense for Reserve Affairs, the Government Accountability Office, Congressional Budget Office, and the Center for Strategic and Budgetary Assessment as well as private sector companies.

During the development of this cost methodology study, a bottom-up approach was utilized to accurately capture all costing elements. From January 29, 2012 to May 24, 2012 the Board's project team convened 16 meetings with costing experts from across the Department in order to examine and compare current AC/RC costing practices across Services and Components. This "bottom-up" assessment of the current use of cost elements within the Department revealed the need for a new DoD policy and culminated in the Board's Interim report delivered in June 2012. In subsequent months, the research team pursued a "top-down" quantitative analysis of the Fiscal Year 2013 federal budget request as detailed in DoD's "Green Book" and related budget materials. In total, the RFPB project team held more than 100 meetings for substantive discussion and examination of the data. The meetings provided quantitative validation of the relative importance and fully-burdened value of the various cost elements and revealed the following findings:

1. The cost of an RC service member, when not activated, is less than one third that of their AC counterpart. According to RFPB analysis of the Fiscal Year 2013 budget request, the RC per capita cost ranges from 22% to 32% of their AC counterparts' per capita costs, depending on which cost elements are included.
2. While Reserve Component forces account for 39% of military end strength, they consume only about 16% of the Defense budget.
3. Reserve component members receive a smaller retirement than their active component counterparts. The RC accounts for approximately 17% of DoD retiree payout. The FY 2013 average Retired Pay Accrual is \$12,834 per AC service member, but only \$3,419 per RC service member.
4. Reserve component members incur lower health care costs. For FY 2013, DoD requested \$32.5 billion for the Defense Health Program (plus nearly \$8 billion in military medical personnel funds and nearly \$7 billion in Medicare-eligible Retiree Health Care accrual funds) to serve more than 9.5 million beneficiaries. Only about 21% of those beneficiaries are from the Reserve Components, and as a whole, the RC member uses the system less than AC members.
5. RC members serve in their home town and rarely incur military moving costs for "Permanent Change of Station", for which DoD requested \$3,260 per AC service member in FY'13.
6. With few exceptions, Reserve families do not send dependent children to DoD schools, and only reservists serving on active duty are counted for Impact Aid calculations. For FY 2013, the DoD Education Activity requested \$2.7 billion and the Department of Education's "Impact Aid" program requested \$505 million. The project team estimates that reservists account for approximately 1% of the DoD's and approximately 2% of the Department of Education's funds to educate military dependents.
7. Generally, reservists are ineligible to use the military family housing system, which required \$1.3 billion to build and operate in FY'13. Only reservists on active duty orders qualify for on-base housing, and few use it
8. Reservists do not drive the need for military commissaries, which in FY 2013 cost \$1.37 billion over and above revenue income in order to operate. Only 3% of commissary users are from the Reserve Component.
9. Since the Reserve Component does not require as much infrastructure as the Active Component, it incurs a far lower cost for base operations support, such as

maintenance, security, and utilities costs associated with the housing, childcare and recreation facilities found on major bases. This is true whether the reservist is mobilized or in a drill status. Of the roughly \$36 billion in DoD Base Operations Support costs, about 12% is appropriated for Reserve Components.

10. Reservists account for a relatively small portion of the contributions made by the U.S. Treasury over and above the DoD budget for defense-related costs.
  - a. The U.S Treasury's direct contribution for "Concurrent Receipt" of both military retired pay and Veterans disability compensation was estimated at \$ 6.95 billion for FY 2013, but only 9% is attributable to RC recipients.
  - b. The U.S Treasury direct contribution for Medicare-Eligible Retiree Health Care Fund (MERHCF) over and above the DoD contribution was estimated at \$6.44 billion in FY 2013, but only 29% of the liability for that cost is attributable to the Reserve Components.
  - c. The U.S Treasury direct contribution to the Military Retirement Fund over and above the DoD contribution was estimated at \$67.18 billion in FY 2013, but only 17% of the payout from that fund is made to RC retirees.

In this final report, the RFPB lays the foundation for answering the Secretary's call at the September 5, 2012 RFPB meeting to provide him with advice and guidance on: the best balance between active and reserve forces, the cost of a strong reserve, and how to achieve savings in the Reserve Components. To meet these objectives, the Board felt that addressing all of the specific cost factors associated with Active Component and Reserve Component members must be compared and included in a consistent manner in order to significantly reduce the current data gap in its AC/RC cost analyses. Therefore, the RFPB recommends mandatory inclusion of specific cost factors in all future Departmental studies comparing the costs of Active and Reserve Components in order to accurately capture the fully-burdened and life-cycle costs of military manpower.

In particular, the RFPB found that the Department of Defense is neither complete nor consistent in its consideration of some of the most important cost factors when weighing the relative costs of Active and Reserve Component forces. While the Services generally do consider basic costs associated with Active and Reserve Component personnel accounts (like the annual appropriations pay accounts), there are significant costs paid from other accounts (either at the DoD level or by other federal agencies) that are not counted in AC/RC comparative cost analyses. Current methodologies used in DoD omit as much as \$600 billion in annual costs. Consequently, such analyses fail to reflect the fully-burdened cost to the Department of Defense and other Federal agencies, much less to the American taxpayer.

In response, the RFPB makes six recommendations in this report. In short, they are:

1. Establish DoD policy/guidance for computing fully-burdened Military Personnel Costs for the Total Force.
2. Specify all the cost elements that must be included in cost studies.
3. Identify mission support, Treasury contributions, and all other external costs that must be considered.



4. Calculate and report cost element figures annually.
5. Clarify the use of composite rates in studies.
6. Develop a model to calculate and compare life-cycle costs.

Each of these recommendations is explored more fully in the body of this report. However, the primary purpose of the recommendations in this report is to ensure senior DoD leaders receive accurate analysis products that are based on more complete and consistent data. The Board believes that the establishment of a standard costing method for determining individual component costs is essential when exploring AC/RC component mix and mission alternatives in a budget constrained environment. The Director of CAPE must take the lead for the Secretary of Defense in determining the cost methodology ground rules for the military departments and other DoD entities.

## **THE TASK**

At the November 29, 2011 meeting of the Reserve Forces Policy Board, the Chairman of the RFPB, in accordance with the RFPB statute, raised for Board consideration the need for the Department of Defense to develop a methodology to examine both the “fully-burdened” and “life-cycle” cost of its forces so that senior leaders could make more fully-informed decisions about the long-term sustainability of the All-Volunteer Force and the future mix of Active and Reserve Component forces. This policy gap became apparent from comments made by the outgoing Assistant Secretary of Defense for Reserve Affairs and other senior DoD leaders. Upon Board approval and direction by the Chairman, the Military Executive of the Reserve Forces Policy Board initiated a staff project to examine DoD costing methodologies and policies for the Total Force.

Additional focus on the importance of completing this project occurred when, at the September 5, 2012 meeting of the Reserve Forces Policy Board, the Secretary of Defense met with members of the RFPB and charged them to provide him with advice and guidance regarding the best balance between active and reserve forces, the cost of a strong reserve, and how to achieve savings in the Reserve Components. This report addresses the issue of cost of the reserve component member. Responses to the other topics raised by the Secretary will be included in future reports.

## **THE PROBLEM**

The fully-burdened and life-cycle cost trends supporting the current All-Volunteer force are unsustainable. The Secretary of Defense, current and former senior DoD officials, and prominent think tanks alike have all underscored this problem.

The DoD cost of “taking care of people” now consumes more than \$250 Billion or over 50 percent of the total DoD budget. An additional \$200 Billion is spent by organizations outside of DoD for programs within the Departments of Veterans Affairs, Labor, Education, and Treasury. Secretary Panetta has stated that “the escalating growth in personnel costs must be confronted. This is an area of the budget that has grown by nearly 90 percent since 2001” for

approximately the same size force. Specifically, military healthcare and retirement costs have increased to about \$50 billion (SECDEF's words in same testimony) and \$100 billion a year respectively and are projected to continue their climb.

Former Secretary Gates stated that changing from "a culture of endless money where cost is rarely a consideration" to a "culture of savings and restraint" is essential. Other senior officials with detailed knowledge have echoed the concern. Notably, the current Under Secretary of Defense Comptroller, the Honorable Robert Hale has said, "the cost of pay and benefits has risen more than 87 percent since 2001, 30 percent more than inflation."

Respected think tanks have produced analysis with similar findings. This year, the Congressional Budget Office said that military compensation has outpaced inflation rates and private sector wages by more than 25 percent during the past decade. Additionally, the Center for Strategic and Budgetary Assessment offered the following sobering commentary in July 2012 on military personnel costs: "Over the past decade, the cost per person in the active duty force increased by 46 percent. If personnel costs continue growing at that rate and the overall defense budget remains flat with inflation, military personnel costs will consume the entire defense budget by 2039."

The Reserve Forces Policy Board contends that DoD does not know, use, or track the fully-burdened and life-cycle costs of military personnel in decision-making. The former Assistant Secretary of Defense for Reserve Affairs, the Honorable Dennis McCarthy describes his experience dealing with this issue as follows: "One of my main tasks...was to lead a "comprehensive review" of the Guard and Reserve. My main frustration...was that we couldn't get agreement on how to calculate the cost of personnel. We need an apples-to-apples methodology that accurately calculates the true cost of people in the Active and Reserve Components." The Board agrees with the former Assistant Secretary and further postulates that absent written policy on a Total Force (active, civilian, contractor, and reserve component personnel) costing methodology, major decisions on future force structure may be made that are uninformed on the true fully-burdened and life-cycle manpower costs.

## **PROJECT PHILOSOPHY/APPROACH**

This report's primary purpose is to provide Department senior decision-makers with an independent, objective method to develop and present repeatable data on the fully-burdened and life-cycle costs of military personnel, providing these decision-makers with the ability to track trends over time, and to permit objective comparative analysis. The Board wants to make clear at the onset that it is not advocating for more reserve or less active component forces. Nor is this study an effort to reform the pay, compensation, and benefits systems or challenge the rationale on current spending levels of the cash and non-cash cost elements supporting the All-Volunteer Force. In September, 2012, the Secretary of Defense charged the RFPB with the task of giving him advice on the cost of a strong reserve and how to achieve savings in the Reserve

components. This report establishes the foundation that will both educate Department senior decision-makers, and help the Board formulate future answers to the Secretary's questions.

The Board notes that cost is not and should not be the sole basis for determining force structure and the mix of active, reserve, defense civilian and contractor personnel. Other key factors include requirements, capability, capacity, risk and expectations of future demand, such as deployment frequency, duration, speed of response, and the readiness levels necessary for given mission sets. Often these factors require subjective determinations based on military judgment. However, as the Nation faces an era of persistent fiscal constraint, cost will be an increasingly important element in Defense decision-making. To support such decision-making it is essential that DoD's cost-estimating methodology – the objective side of the equation – be as complete and consistent as possible.

The staff study group addressed the DoD military personnel cost data gap by researching existing policy documents on costing methodology in the DoD Comptroller and Cost Assessment Program Evaluation (CAPE) offices to determine if there were any policy gaps. The group found that although individual cost studies have been conducted in the past, there is no DoD consensus or standardized costing process for use by all Services; they all use different cost elements for military personnel cost comparison and none consider **all** the costs.

The Board found it curious that DoD requires **all** costs to be included and considered in major acquisition decisions, but not for military personnel. In the acquisition world, mere “fly away” costs are deemed inadequate. DoD uses the all-in program acquisition unit cost and provides life-cycle operating costs. Neither DoD nor the Congress would make major acquisition decisions without knowing the full costs. Additionally, DoD now uses the Fully-Burdened Cost of Energy (FBCE) calculations to consider long-term fuel costs in procurement decisions. Finally, the Department requires contractors to invoice the fully-burdened cost of their personnel working for DoD. Thus, the Board feels that a similar fully-burdened and life-cycle approach should inform senior DoD leaders' decisions on military personnel where the life-cycle and fully-burdened costs are just as substantial.

To better understand the current practice of how DoD compares the cost of both components of military personnel (Active and Reserve), the project team convened 16 working group meetings, consisting of cost experts from across the Department in order to examine and compare current Active/Reserve Component costing practices across Services and Components. The work group identified and compared **all** of the various cost elements. This group found that the inclusion and use of these cost elements varied widely. Within DoD today, military personnel costing is neither complete nor consistent. Although the Director of Cost Assessment Program Evaluation has published guidance (DTM 09-007 currently, with DoDI 7041.dd as a replacement) providing a starting framework to move in the right direction, the documents do not provide the Services and Components with all fully-burdened and life-cycle costing elements. Additionally, neither document includes Reserve Component costing tables.

The reason that this inconsistency in cost analysis matters is there are decisions being made by senior DoD officials that impact future total force structure, and there are vast differences between reality and myth on the costs of our All-Volunteer force, both Active and Reserve Component personnel. If one examines all of the costs within the DoD budget, as well as applicable federal programs outside of DoD, a Reserve Component service member costs less than 1/3 that of an Active Component service member.

## METHODOLOGY

The project team used a “layer cake” approach built from the bottom up to ensure all stakeholders were included and heard. The first layer included costing experts from all of the Services and Components. These individuals reviewed previous costing studies, then identified the various fully-burdened and life-cycle individual cost elements and developed options and recommendations for use. The next three layers entailed vetting the work done with active and reserve leadership from each of the military services, and key decision makers and subject matter experts from within and outside the Department. These included visits with the Director, CAPE, USD (C), USD (P&R), Deputy Director, Joint Staff J8, Deputy Director, DOD Office of the Actuary, Government Accountability Office, Congressional Budget Office, and Center for Strategic & Budgetary Assessments just to name a few. Overall, RFPB members and/or staff conducted more than 100 meetings with senior officials and experts inside and outside the Department of Defense to collect data, conduct analysis, and receive a diverse range of inputs, opinions, and perspectives.

The foundation for analysis began with the identification of costs at the individual level in order to enable “apples-to-apples” comparisons. Seeking common business case analysis processes, identifying and capturing ‘lessons-learned’ from previous analysis across the Services and Components, and having DoD follow the same requirement they impose on contractors to allocate all costs were identified as keys to this study.

From January 29 to May 24, 2012, the RFPB project team conducted a “bottom-up” review of current AC/RC costing practices across the services and components. During 16 meetings, an informal working group, consisting of costing experts from across the Department, examined and compared these different methodologies. First, the working group developed a schedule to identify all tasks and deliverables. Next, based on the recommendation of the Deputy Director, CAPE, the project team examined Directive Type Memorandum (DTM) 09-007; the Department’s policy on the subject of “Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support” dated September 2, 2011. This policy identifies for DoD analysts the cost elements to be examined when studying full-time staffing options. Using DTM 09-007 as a baseline, the task group identified several costing element discrepancies between the Service’s Reserve Components and missing cost elements. Finally, the group developed a model for presenting all Service cost elements and provided recommendations on needed DoD policy changes.

In June 2012, the project team began an independent “top down” analysis of the DoD FY 13 budget request in order to determine and demonstrate the feasibility of calculating a true, “fully-

burdened” per capita cost of Active and Reserve Component forces, and use those calculations to independently quantify the relevant cost factors.

Additionally, the project team conducted roughly 100 visits with senior officials and costing experts inside and outside of the Department of Defense.

## RECOMMENDATIONS & FINDINGS

**Recommendation #1 - Establish DoD policy/guidance for computing fully-burdened Military Personnel Costs for the Total Force.** The Director of Cost Assessment and Program Evaluation (CAPE) should establish permanent DoD policy for calculating the “Fully-Burdened” costs of individual members from both the active and reserve components.

As noted in the RFPB’s Interim Report of June 2012, the Department of Defense has no policy in place to define or require complete analytical data for the comparison of Active and Reserve Component costs to determine Total Force mix options. As a result, senior leaders within DoD do not have complete or uniform data on the total costs associated with such forces. Therefore, decisions about the optimal mix of future Active and Reserve Component forces are not fully informed, and an “apples to apples” comparison is not possible.

While DoD has no policy in place to define or to require consistent or complete analytical data for the comparison of Active and Reserve Component costs for force mix options, it does have a policy guiding the collection and analysis of comprehensive cost data for comparing military, government civilian, and contractor full-time staffing options.

Directive Type Memorandum (DTM) 09-007 was DoD’s initial attempt at establishing policy on “Estimating and Comparing the Full Costs of Civilian and Military Manpower and Contract Support,” dated September 2, 2011. Currently, the Deputy Director of CAPE is circulating a new Department of Defense Instruction (DODI 7041.dd) to replace DTM 09-007. It too identifies the cost elements necessary to calculate and compare the full cost of full-time staffing options. However, neither document examines part-time staffing, includes **all** costing elements, nor addresses comparisons of Active and Reserve Component forces. Even so, this product is a commendable example of the type of guidance that DoD should produce with regard to Active/Reserve Component cost comparison. In its Interim Report, the Board recommended that there should be such a policy.

Subsequently, the Director of CAPE has indicated that their office agrees that there is value in having such cost comparison guidance in place, and will begin crafting one. The RFPB applauds the willingness of CAPE to tackle this objective.

**Recommendation #2 - Specify all of the cost elements that must be included in cost studies.** DoD Policy should require that any study conducted or contracted by the Services or other DoD component for the purpose of comparing the costs of active and reserve component personnel or forces include, at a minimum, the following cost factors: Basic Pay, Retired Pay Accrual, Allowances, Incentives & Special Pay, PCS Costs, Medicare-Eligible Retiree Health Fund Contribution, DoD Healthcare Costs, DoD & Department of Education Dependent Education Costs, DoD & Service Family Housing Costs, DoD Commissary Costs, Treasury Contribution for Concurrent Receipt, and Base Operations Support Costs.

In the draft DODI 7041.01, the Director, Cost Assessment Program Evaluation's staff has identified forty two (42) cost elements and data sources for the calculation of the "fully burdened" cost of full-time military manpower. Twenty nine (29) of these cost elements come from Personnel appropriation accounts that are included in the annually-calculated "Composite Rate" for each rank/grade within each Service, as required by the DoD Financial Management Regulation. The remaining cost elements are in the areas of Health Care, Education Assistance, Discount Groceries, Child Development Program, Training, Recruitment, Dependent Education, Veterans benefits and Treasury Contributions.

Taking the list of military cost elements from DTM 09-007 (converted to DODI 7041.01) as an apparently strong and comprehensive set, the RFPB project team sought to determine the degree to which the Services and Reserve Components were utilizing these costing elements in calculating the comparative costs of AC and RC personnel – even in the absence of a DoD policy directing them to do so.

From January 29 to May 24, 2012, the RFPB project team convened 16 meetings bringing together experts in the field of costing from the various Reserve Components as noted above in the Methodology section of this report. As a result of these meetings, the RFPB project team found that the services were neither complete nor consistent in the use and consideration of the various cost factors in determining Reserve Component costs. All components (predictably) used personnel costs such as Basic Pay and Housing Allowances in their cost analysis, but there was wide variance in the use of many other cost factors. No component consistently took into consideration the military-related costs borne by other federal agencies such as the Departments of Education, Treasury, Labor or Veterans Affairs. Notably, the working group identified that Family Housing was an additional relevant compensation cost factor, but one which is neither included in DTM 09-007 (or the replacement DODI 7041.dd), nor consistently used by components in cost analysis.

Subsequently, in order to quantify the relative importance of all of the possible military cost factors and identify those most critical for inclusion in future policy documents, the RFPB project team calculated a fully-burdened cost of Active and Reserve Component personnel based upon the Fiscal Year 2013 budget request for the Departments of Defense, Veterans Affairs,

Labor, Education and Treasury. The basic approach in this calculation was to allocate all DoD costs and appropriate costs of other Departments to either Active or Reserve Components. In this analysis, costs were allocated to Active and Reserve Components just as the funds were requested in the various component appropriation accounts. Defense-wide accounts were allocated based on identifiable “fair share” quantitative multipliers. Where no such multipliers were apparent, Defense-wide costs were allocated on an equal per capita basis. Unquestionably, this calculation required some assumptions and even judgment calls that not everyone will agree with. The actual numbers in the resulting calculations are less important from a policy perspective than their relative values, which clearly demonstrate the importance of addressing the existing data gap with an effective and comprehensive policy for the future. The results of this analysis are presented within Appendix B of this report.

In short, based upon findings from this analysis, the RFPB recommends that DoD policy mandate that any studies conducted, contracted, or commissioned by the military services or any other DoD component for the purpose of comparing the costs of Active and Reserve Component personnel or forces must, as a minimum, include the following cost factors:

- Personnel Costs
- Health Care
- Dependent Education
- Family Housing
- Commissaries
- Concurrent Receipt
- Base Operations Support

### **Personnel Costs**

The annually-calculated “Composite Rate” for each rank/grade within each Service as required by the DoD Financial Management Regulation includes basic pay, allowances for housing, subsistence, uniforms, incentives and special pays, education assistance, contributions for retirement pay accrual and to the Medicare Eligible Retiree Health Care Fund (MERHCF), and essentially all other funds within the Service component’s personnel appropriation account.

While these cost elements alone are insufficient to arrive at a “fully-burdened” cost, all of them are essential when dealing with a comprehensive comparison of Active and Reserve Component costs.

Retirement pay accrual is a particularly important cost element needed for inclusion. In view of the differences in the Active and Reserve Component retirement systems, it is imperative that future AC/RC cost studies fully consider the impact of the resulting differences in retirement costs. Inclusion of the annual budget appropriations for retired pay accruals for Active and Reserve Components is an actuarially sound mechanism to capture the present value of these significant future costs. Using this approach recognizes the importance of life-cycle costs for Active and Reserve Component mix decisions. Consequently, the retired pay accruals are a critical cost element for inclusion.

The project team found that the Services and Components generally include these personnel costs (including the retirement accrual payments) in comparative cost calculations for Active and Reserve Components. This practice should be continued and codified in future DoD policy.

The test for completeness of such calculations should be whether or not the resulting aggregate sums account for essentially all of the service component's personnel appropriation for a given fiscal year.

### **Health Care**

Health care is a major cost to the Department of Defense. The cost of providing health care to Active Component service members is vastly higher than it is for Reserve Component members.

For Fiscal Year 2013, the Department of Defense has determined that the cost of medical health care for active duty personnel and their dependents is \$10,563 per capita. This is included in the annual rate billable to other federal agencies when obtaining reimbursement for services provided to agencies outside of DoD. The Department publishes no similar annual calculation for Reserve Component members.

To illustrate one method of filling this data gap, the Reserve Forces Policy Board staff examined the \$32.5 billion requested in the FY 2013 budget for the Defense Health Program. The program serves more than 9.6 million beneficiaries. Approximately 7.6 million beneficiaries are active component service members, while the vast majority of users are active component family members and retirees. On the other hand, Reserve Component service members, retirees and their family members comprise only about 21% of the total military healthcare beneficiaries (approximately 2 million). Thus, apportioned on a per capita basis across the two components, the project team estimates that Defense Health Program actually costs more than \$19,000 per Active Component member, in contrast to just over \$8,000 per Reserve Component member.

In addition to the \$32.5 billion for the Defense Health Program, the Department also requested nearly \$8 billion in military medical personnel funds and nearly \$7 billion in Medicare-eligible Retiree Health Care accrual funds. The Congressional Budget Office further opines that the Fiscal year 2103 budget request understated military healthcare costs by about \$4 billion so that the actual total cost is potentially more than \$50 billion.

A major cost of the health care system that is frequently omitted from AC/RC cost comparisons is the cost of providing health care to Active Component retirees. This is a significant cost that is not reflected in the annual reimbursement rate calculated under the DoD Financial Management Regulation. It is, however, a legitimate cost of the Active Component and should be included in analyses.

When health care costs are ignored in AC/RC cost comparisons, the results are skewed. For example, DoD cost savings for a shift of force structure from Active to Reserve Components will be notably understated. Likewise, the additional cost burden of shifting force structure from Reserve to Active Components will be similarly understated.



In order for future cost comparison studies to more accurately reflect the true cost to the Department of Defense, it is imperative that future DoD policy require that such studies fully account for the costs of health care. These studies should include a calculation of the present value of the future cost burden the Department will bear for retirees.

### **Dependent Education**

Dependent children of active component service members are eligible for education in schools operated by the Department of Defense. However, if the active duty service member sends his or her children to local public schools, then that public school system receives funding from the Department of Education on a per-child basis. Because active duty service members can live and work on federal property, and thus not pay local property taxes, “Impact Aid” provided by the Department of Education to local governments helps compensate the community for the cost of educating active duty military children.

The FY 2013 DoD budget includes more than \$2.7 billion in Defense-wide Operations and Maintenance funding for dependent education. The Department of Education budget includes an additional \$500 million to fund “Impact Aid” to civilian schools for the cost of students from military families.

Neither of these Department of Defense or Department of Education dependent education benefits is provided to part-time Reserve Component service members. Their children are ineligible for DoD schools and are not included in the Department of Education’s “Impact Aid” program. Reservists live in the communities and pay local and state taxes. Only a comparatively small number of reservists serving on full-time active duty incur these costs. As a result, the RFPB project team estimates that the annual federal government costs for dependent education totals \$2,389 per active component service member compared to just \$42 per Reserve Component service member.

In order for future cost comparison studies to more accurately reflect the true costs to the federal government, it is imperative that DoD policy require future studies to fully account for the costs of dependent education. This includes costs incurred by the Department of Defense, as well as those incurred by the Department of Education.

### **Family Housing**

Part-time Reserve Component personnel are not eligible for military family housing when not mobilized. Only a comparatively small number of reservists serving on full-time, active duty orders qualify for this benefit. Because most reserve units are located in civilian communities rather than on major military installations, even these full-time reservists tend to live in civilian housing off-base.

In addition to the Basic Allowance for Housing paid to service members on active duty, the Department incurs yearly costs in both Service-level and DoD-wide accounts for new construction, as well as the operation and maintenance of 42,000 military family housing units. The FY 2013 DoD budget request included an annual cost of more than \$1.6 billion for these purposes. This figure does not include “sunk costs” from any construction in past years.

In order for future cost comparison studies to more accurately reflect the true cost to the Department of Defense, DoD policy studies should require inclusion of the full costs of family housing, including costs in both service-level and defense-wide accounts for construction, as well as operations and maintenance of family housing.

### **Commissaries**

The Department of Defense spends about \$1.4 billion annually to subsidize discount groceries to service members and retirees through the operations of the Defense Commissary system. Reserve Component service members tend not to use military commissaries. Survey data from the Defense Commissary Agency shows that only 3% of commissary users are from the Reserve Component. This is consistent with the findings of a May 2000 study by the Food Marketing Institute, which estimated that 5% of commissary users were reservists. The relatively low usage by Reserve Component members is not surprising. The average American lives less than six miles from a supermarket. In contrast, 54 percent of Reserve and National Guard units are located more than 20 miles away from a military commissary.

In order for cost comparison studies to more accurately reflect the true costs to the Department of Defense, future DoD policy should require that such studies account for the costs of operating the Defense Commissary system and apportion those costs according to usage.

### **Concurrent Receipt – Treasury Contribution**

Military Retirees are allowed to draw both their military retired pay from the Department of Defense, plus any disability compensation paid by the Department of Veterans Affairs. This benefit, established in the 2004 National Defense Authorization Act, is known as “concurrent receipt.” It is funded not by the Department of Defense, but rather by direct contributions made by the Department of the Treasury from the General Fund of the United States.

This benefit is disproportionately drawn by retirees from the Active Components. According to the September 30, 2011 Statistical Report on the Military Retirement System (the most current available), there were a total of nearly 319,000 retirees drawing concurrent retirement and disability pay. Only about 5% or 16,000 of these were reserve retirees. Moreover, the Reserve Component retirees who do draw the concurrent receipt draw smaller amounts. While the average active duty retiree draws almost \$1,400 per month in concurrent receipt pay, the average Reserve Component retiree draws just over \$1,000 per month. Overall, reservists draw approximately 4% of the total payout for concurrent receipt pay.

For the October 1, 2012, Treasury payment, the amount due to Concurrent Receipt totals \$6.8 billion. This is \$6.5 billion for full-time service members as compared to \$0.3 billion for part-time service members. Even noting that roughly 5% of full-time service members are reservists on active duty in support of the reserves (also known as the Active Guard and Reserve program), the Reserve Component only accounts for 9% of the actuarial liability to the U.S. Treasury for Concurrent Receipt.

In order for cost comparison studies to more accurately reflect the true costs to the Department of Defense, future DoD policy should require that such studies account for the costs borne by the United States Treasury for Concurrent Receipt payments.

## **Base Operations Support**

The Reserve Component does not require the huge facility and base infrastructure as does the Active Component. As a result, the Reserve Component incurs a far lower cost for base operations support such as maintenance, security, and utilities costs associated with the housing, childcare and recreation facilities found on major bases. Of the roughly \$36 billion in DoD Base Operations Support Costs, about 12% is appropriated for Reserve Components.

In order for cost comparison studies to more accurately reflect the true costs to the Department of Defense, future DoD policy should require that such studies account for the costs of Base Operations Support.

**Recommendation #3 - Identify mission support, Treasury contributions, and all other external costs that must be considered.** DoD Policy should require that any study comparing the costs of Active and Reserve Component personnel or forces consider the amounts, degree and methodology for possible inclusion of all or part of the annual contributions made by the U.S. Treasury, Veterans costs, and the non-compensation costs of the Department of Defense.

## **Treasury Costs**

The United States Treasury covers several costs of our national defense that are not appropriated in the annual budgets of the Department of Defense.

Reserve Component members account for a disproportionately small portion of the contributions made by the U.S. Treasury (over and above the DoD budget) to defense-related costs. The Treasury contribution for Concurrent Receipt was already noted above. Additionally, the U.S. Treasury direct contribution for the Medicare-Eligible Retiree Health Care Fund (MERHCF), over and above the DoD contribution of \$6.7 billion, was estimated at another \$6.44 billion in FY 13, but only 29% of the liability for that cost is attributable to the Reserve Components. The U.S. Treasury direct contribution to the Military Retirement Fund, over and above the DoD contribution, was estimated at \$ 67.18 billion in FY 13, but only about 17% of the payout from that fund is made to RC retirees.

Developing a complete understanding of these costs to the federal government (the precise degree to which they can or should be allocated as Active or Reserve Component costs) and the circumstances where these costs should be included or considered is a significant task beyond the scope of this report. The Department should study these issues and develop a policy to appropriately account for and allocated them for the purpose of force-mix studies. The RFPB concluded that these costs should be included in future cost comparisons but recognizes the Department need to take the leadership role.

### ***Contributions for Military Retirement***

For FY 2013, DoD is projected to pay, from its appropriations, about \$21.6 billion into the Military Retirement Fund. This amount is shown in each of the service's military personnel budgets as "Retired Pay Accrual." This appropriation covers the accruing costs of future retirement benefits being earned by today's service members. This amount continues to increase due to the larger number of retirees as well as the increase in life expectancy of future retirees.

However, over and above this amount, the United States Treasury contributes an additional \$67.2 billion into the Military Retirement Fund. This amount covers a portion of the accrued unfunded liability for all the retirees and current members who earned benefits before the accrual funding system was set up in 1985.

This additional Treasury contribution is necessary in order for the fund to make its anticipated disbursements in payments to retirees of \$53.1 billion and to grow the fund toward eventual self-sufficiency. While the Reserve Components account for 39% of today's Total Force, the project team estimates that Reserve Component retirees' account for only about 17% of the payout from the Military Retirement Fund.

To function, the fund purchases United States Treasury Bonds and derives income from the interest on those bonds. While not a cost to the DoD budget, the additional Treasury contribution is a burden on the national debt. This burden could shift if significant changes were made in the mix of Active and Reserve Component forces. However, determining the degree and direction of this shift would require additional study beyond the scope or capability of this report. The RFPB believes the Department should undertake this additional analysis.

### ***Contributions to Medicare-Eligible Retiree Health Care***

The clear need to properly allocate the significant annual costs of military retirees who are under the age of 65 and thus not eligible for Medicare is addressed above in this report in the Health Care section under Recommendation #2. These costs are paid directly out of the DoD annual appropriations rather than on an accrual basis.

For those retirees who are age 65 and older ("Medicare Eligible"), some – but not all – of their health care expenses are paid for from the Medicare Eligible Retiree Health Care Fund. As with the Military Retirement Fund, this is also an accrual fund.

For FY 2013, DoD is projected to pay (from its appropriations) about \$6.7 billion into the Military Retirement Fund. This amount is shown in the service military personnel budgets as "Medicare Eligible Health Care Fund Contribution" (MERHFC). This fund covers the liability for future benefits accruing to current service members.

However, over and above this amount, the United States Treasury will contribute an additional \$6.4 billion into the Fund. This is an annual payment from the general fund of the Treasury on the accrued unfunded liability and is necessary to make the estimated \$10 billion payout from the fund in 2013.

While the Reserve Components account for 39% of today's Total Force, the project team estimates that Reserve Component retirees account for about 29% of the payout from the Medicare Eligible Retiree Health Care Fund

Like the Military Retirement Fund, the Medicare Eligible Retiree Health Care Fund also purchases United States Treasury Bonds and derives income from the interest on these investments. While not a cost to the DoD budget, the additional Treasury contribution is a burden on the national debt. This resulting additional burden to the Nation's debt could shift somewhat if major changes were made in the mix of Active and Reserve Component forces. Determining the degree and direction of this shift, however, would require additional study beyond the scope or capability of this report. The RFPB believes the Department should undertake this additional analysis.

### **Veterans Costs**

The raising, maintaining, and employing of military forces eventually contributes to a bill for the American taxpayer for Veteran's benefits and healthcare.

The budget request for the Department of Veterans Affairs for FY 2013 was more than \$140 billion. Additionally, the Department of Labor sought nearly \$259 million for its Veterans Education and Training Service. The programs of these two departments serve the estimated 22.2 million veterans in America. This comes to a little more than \$6,200 per veteran, per year.

The project team did not find an obvious model or mechanism for determining different allocation costs for Active and Reserve Component veterans. Consequently, the project team assumed that Active and Reserve Component service members consume an equal level of veteran's benefits and services. The question of whether there is, in fact, a difference merits more thorough analysis. If a subsequent analysis determines that there is such a difference, that difference should be included for consideration in future costing studies. The RFPB recommends that this additional analysis be done.

### **Non-Compensation Costs of DoD**

Service-level non-compensation costs such as Other Operations and Maintenance, Procurement, Military Construction, Research and Development, and training costs vary from service to service, but still merit explicit DoD guidance for inclusion in future AC/RC cost studies. The costs total more than \$350 billion and must be considered.

#### ***Other Operations & Maintenance Costs***

As stated under Recommendation #2 above, the Board recommends that certain Operations and Maintenance costs such as Base Operations Support costs, family housing operating costs, health care and dependent education should be consistently included in calculations of the fully-burdened cost of Active and Reserve Component forces.

Roughly \$135 billion in other funds from "Operations and Maintenance" (O&M) accounts are used for a broad range of expenses including fuel, spare parts, supplies, service contracts, and civilian pay. These other O&M costs should be considered in costing studies and included when appropriate.

Each Reserve Component has its own O&M account that Congress appropriates funding into based on the annual budget request. Reserve Component O&M totals about \$21 billion. Active Component O&M for the four Services totals about \$120 billion. Consequently, most O&M funding is already clearly allocated between Active and Reserve Components.

One notable exception is the \$32 billion “Operations & Maintenance – Defense-Wide” account. This account includes funding for activities which support both Active and Reserve Components. While the bulk of the account funds Active Component activities, it also funds some activities that at least partly support the Reserve Components. These activities include Civil Military Programs, Defense Finance and Accounting Service, National Defense University, Defense Media Activity, Defense Human Resources Activity and the United States Special Operations Command.

The O&M Defense-wide account also includes DoD Dependent Education (\$2.7 billion), which is addressed separately in the report above because it is a form of compensation.

Overall, the project team estimates that only about 4% of the total \$32 billion O&M Defense-wide account is attributable to Reserve Component expenses.

In developing future policy regarding AC/RC costing, DoD should consider allocation of the full O&M Defense Wide account as cost factors when calculating comparative, fully-burdened costs.

### ***Procurement***

Funds from “Procurement” accounts are used to purchase major items of equipment including aircraft, armored vehicles, trucks, weapons, communications systems, missiles and ammunition. No Reserve Component has its own procurement account. Reserve Component equipment is funded and procured strictly through the Service procurement accounts.

The DoD Budget Request which goes to Congress each year includes a publicly-available exhibit that identifies which part of the Department’s procurement funding request it plans to use for the purchase of Reserve Component equipment. The “Procurement Programs – Reserve Components” (P-1R) exhibit is a subset of the Procurement Programs exhibit. It reflects the Service estimates for those funds used to procure equipment for the National Guard and Reserve. For example, for FY 2013 DoD requested \$98.8 billion in total procurement. The P-1R exhibit for FY 2013 shows that, of that amount, the Department intends to spend \$3.1 billion for the purchase of Reserve Component equipment – only about 3% of the total.

This amount funds the procurement of new equipment or major upgrades to existing equipment. It does not cover transfers of used equipment from the active to the Reserve Component. Detailed information about such transfers of equipment can be found in the annually published “National Guard and Reserve Equipment Report” produced by the Assistant Secretary of Defense for Reserve Affairs. It is available on the internet.

In developing future policy regarding AC/RC costing, DoD should consider allocation of procurement account costs when calculating comparative, fully-burdened costs. The P-1R should be the basis for such an allocation.

### ***Military Construction Other than Family Housing***

Military Construction funding is used to build new facilities and infrastructure. For FY 2013, DoD requested \$8.7 billion for this purpose.

The need to consistently include Family Housing construction and operating costs in future costing studies is addressed above. The Board feels that other Military Construction costs should be considered and included in such studies as appropriate.

Each Reserve Component has its own Military Construction account that Congress appropriates funding into based on the annual budget request. In Fiscal Year 2013 budget request, Reserve Component Military Construction totals about \$1 billion. Active Component Military construction for the four Services totals about \$4 billion. Consequently, most Military Construction funding is already clearly allocated between active and Reserve Components.

One notable exception is the \$3.7 billion “Military Construction – Defense Wide” account. This account includes funding for construction of some facilities that support both active and Reserve Components. Additionally, some facilities built with active component Military Construction funds may also, in part, serve Reserve Component forces. The reverse may also be true at times.

This report recommends that future DoD policy should require that any AC/RC cost study include the costs for both building and operating military family housing.

Certain Military Construction costs other than family housing, such as that contained in Defense-wide military construction accounts or for projects which serve both Active and Reserve Components may also merit consideration.

### ***RDTE & Other***

Research, Development, Testing and Evaluation (RDT&E) funding is used to develop new technologies for DoD capabilities. None of the Reserve Components has an RDT&E account. Such basic research and testing would likely be required regardless of the relative active/Reserve Component mix of the Total Force.

Other costs within the Department of Defense budget that are unlikely to be sensitive to changes in AC/RC mix include those for Environmental Restoration, Drug Interdiction, Cooperative Threat Reduction, and the Service-level Working Capital Funds.

Consequently, the value of allocating the RDT&E costs and other accounts is uncertain.

In developing future policy regarding AC/RC costing, DoD could consider allocation of RDT&E and other account costs when calculating comparative, fully-burdened costs, but the project team feels there would be minimal value in such allocations.

### ***Training***

A significant portion of the training costs for Reserve Component members is conducted by the Active Component at their expense. This varies from service to service. In developing

future policy regarding AC/RC costing, DoD could consider allocation of training costs borne by the Active Component to train the Reserve Component.

**Recommendation #4 - Calculate and report cost element figures annually.** The Director, Cost Assessment and Program Evaluation (CAPE) or the Under Secretary of Defense (Comptroller) should calculate and publish all cost elements for Total Force military personnel cost studies on an annual basis, and provide guidance on their use in an appropriate memo or report.

Annual standardized calculations of the required critical cost elements will provide updated and consistent numbers for the Services and other DoD components to use in costing studies.

Additionally, publishing such cost elements annually demonstrates DoD commitment to tracking costs in an increasingly budget-constrained environment.

**Recommendation #5 - Clarify the use of composite rates in studies.** The Under Secretary of Defense (Comptroller) should modify the annual memo on “Military Personnel Composite Standard Pay and Reimbursement Rates” to eliminate the directive to use such rates “when determining the cost of military personnel for budget/management studies.”

This recommendation fixes two currently conflicting DoD policies; one from the DoD Comptroller and one from the Director, Cost Assessment and Program Evaluation (CAPE).

At present, the DoD Deputy Comptroller publishes an annual memo titled “Military Personnel Composite Standard Pay and Reimbursement Rates.” This memo is sent to disseminate the yearly calculation of composite rates. It provides a cost figure for a full-time service member, by grade, in each service. This cost figure is called the “Composite Rate” and includes a limited number of obvious cost elements: Base pay, allowances, PCS costs, retirement accrual and so on. The annual cost memo includes a statement that says, “The composite standard pay rates will be used when determining the cost of military personnel for budget/management studies.”

This guidance is in clear conflict with DTM 09-007 (draft DODI 7041.dd) which states, “the DoD composite rates, as published by the [DoD Comptroller], used to calculate manpower costs for program and budget submissions do not account for the full costs of military or DoD civilian personnel...For this reason, composite rates should not be the only source of data used when answering questions about the cost of the defense workforce, making workforce-mix decisions, or determining the cost impact of manpower conversions.”



The DTM 09-007 (draft DODI 7041.dd) guidance is especially significant, because the composite rate ignores the cost of health care.

DoD Comptroller officials explained to the RFPB project team that the language of the annual memo reference to "management studies" is intended to mean that the Composite Rate is used to calculate the cost of DoD manpower employed in the creation of written reports and studies. If such is the case, then Deputy Comptroller should articulate that point more clearly in their next annual "Military Personnel Composite Standard Pay and Reimbursement Rates" memo. Otherwise, the current wording can, and based on RFPB findings in its work group, has actually been interpreted to suggest that the Composite Rate is sufficient to be used as the basis for calculating manpower costs in studies about management of personnel, units, forces, etc. Consequently, the Comptroller should modify the wording of the annual memo to specify that the Composite Rate is intended to be used for reimbursement by federal agencies and for the calculation of manpower costs associated with the creation of written reports, but that the data (consistent with DTM 09-007) should not be the only source of data used when answering questions about the cost of the defense workforce, making workforce-mix decisions, or determining the cost impact of manpower conversions.

**Recommendation #6 - Develop a model to calculate and compare life-cycle costs.** The Director, Cost Assessment and Program Evaluation (CAPE) should develop a model to calculate and compare the "life-cycle" costs of Active and Reserve Component personnel.

On an annual basis, the cost of a Reserve Component service member is 22% to 32% that of their active component counterpart, depending on what cost elements are included. This fact alone does not fully capture the entire scope of the costs to the Department of Defense or to the federal government, because it ignores the enormous cost of retirement and health care.

The retirement and health care costs for RC forces as compared to their AC counterparts are far lower. The RFPB believes that DoD needs to have improved visibility on these costs over the long term. To assist the Department with the development of a life-cycle model, the Board provides two specific examples that already exist where life-cycle costs are examined and modeled. A previous study by Jennifer Buck, a former Deputy Assistant Secretary of Defense for Reserve Affairs, published in 2008 and the "Individual Cost Assessment Model" or ICAM (presently being vetted by the US Air Force Reserve with the Air Force) are two examples of work that can be used.

### **Retirement Pay Costs**

The Reserve Component retirement benefit is notably less than that of the Active Component. The Reserve Component member is paid a far lower amount for a far shorter period of time. While an Active Component service member can begin drawing retirement pay immediately upon completion of 20 years of service, a part-time Reserve Component member completing 20 years of service generally can draw no retirement pay until age 60. This means that while the Reserve Component retiree draws pay for the roughly 20 years from age 60 until

death, an Active Component retiree leaving the service at age 38 can draw retirement pay for over 40 years – more than twice as long.

Additionally, the retirement pay of the Reserve Component member is less. According to the Statistical Report on the Military Retirement System for FY 2010 (the latest version available), there were 1.47 million non-disability retirees from active duty receiving retired pay. In FY 2010, non-disability retirees were paid \$40.2 billion – an average of \$27,347 per active duty retiree. In contrast, as of the same date, there were 357,000 reserve retirees receiving retired pay. In FY 2010, reserve retirees were paid \$4.89 billion -- an average of \$12,574 per reserve retiree. So, the average reserve retiree receives just 46% of what an active retiree receives. Roughly speaking, a Reserve Component retiree is paid less than half as much for potentially half as long.

These differences in retirement cost are at least partially accounted for in DoD budgeting through the annual retirement pay accrual. However, as noted above, this amount only covers part of total military retirement costs. The United States Treasury makes an additional direct contribution to the Military Retirement Fund in order for benefits to be paid.

### **Retiree Health Care Costs**

Active Component service members retiring with 20 years of service not only receive immediate retirement pay, they also continue to receive lifetime military healthcare for themselves and their dependents. A service member retiring at age 38 can receive this health care benefit for over 40 years. The health care benefit received by active duty retirees until age 65 is not captured by an accrual, but must be fully paid out of the annual appropriations of the Department of Defense. This is roughly \$10,000 per retiree, per year – a major cost which is not incurred by Reserve Component service members.

Up until recently, Reserve Component service members who completed 20 years of service, but had not yet reached age 60 (the so called “Grey area retirees”) were completely ineligible for military healthcare. Though now eligible to enroll, they must pay the full, unsubsidized premium for the coverage.

Retirees age 65 or over are eligible for Medicare. DoD makes an annual contribution into the Medicare Eligible Retiree Health Care Fund. However, that contribution by DoD does not cover the full cost of providing care to those older retirees. The United States Treasury must make an additional contribution to the Medicare Eligible Retiree Health Care Fund in order to meet expenses.

### **Existing Work to Leverage in Developing a DoD Life-Cycle Cost Model**

Only by comparing the life-cycle cost of Active and Reserve Component forces can the full scale of potential savings be quantified for decision-making purposes.

Fortunately, there has been some commendable work already done on the subject of identifying, calculating and using the life-cycle costs of Reserve Component forces. In developing the model recommended above, the Department should leverage these existing works and translate their concepts and ideas into DoD-wide usage.

### ***The Buck Model***

Jennifer C. Buck’s paper “The Cost of the Reserves” was published as a chapter in the book, “The New Guard and Reserve” in 2008 by Falcon Books. In the paper, she identifies three alternative approaches in determining the cost of Reserve Component forces; the traditional, simple method of comparing budget and force structure, the method of evaluating unit costs, and the method of estimating the cost of the “use” of individual members over the course of a career. While Buck’s approach of calculating and comparing the life-cycle costs is a valid approach, the data she used did not reflect fully-burdened costs. This could be rectified in future applications.

To demonstrate the viability of comparing life-cycle Active and Reserve Component individual costs under a given usage level assumption, the project team applied its fully-burdened cost data from analysis of the FY 2013 budget to the Buck model to arrive at the AC/RC Life-Cycle Cost Illustration below.



The above illustration is based on a number of variables and assumptions.

- 20 years of demand for forces at current employ-to-dwell ratios (1:3 AC and 1:5 RC)
- AC annual cost: \$385,000 per capita
- RC annual cost: \$125,000 per capita
- RC costs same as AC for each of four mobilization/deployment years
- Career length: AC=22 years, RC=25 years
- Deployments completed: AC=7, RC=4
- AC retiree costs: \$27,000 in retired pay, \$10,000 in DoD-provided healthcare
- RC retiree draws no retired pay until age 57 (age 60 minus 36 months credit for four 9-month deployments)

- RC retiree costs: \$13,000 in retired pay. At age 65 add \$10,000 in healthcare (Medicare)
- Life Expectancy for both: Age 83

As the Department moves forward to develop a comprehensive model to examine life-cycle costs, the above assumption set shows the type of data needed for inclusion in an actual model.

### ***Air Force Reserve ICAM***

The Air Force Reserve Command has developed a manpower life cycle cost model known as the Individual Cost Assessment Model (ICAM). It has been constructed with the intent of building an enduring analytical tool and capability to support more informed leader decisions. While the ICAM, as of the project team's review in June of 2012, did not include a true fully-burdened set of cost factors, it nonetheless provides a commendable example of the sort of tool that the Department should have available for all Services and Components.

### **CONCLUSION**

The Reserve Forces Policy Board makes these recommendations to the Secretary of Defense under our statutory charter. The RFPB stands ready to make its members and staff available for further consultation or discussion on these matters as the Department shall require.

Respectfully submitted,



Arnold L. Punaro  
Major General, USMCR (Ret)  
Chairman, Reserve Forces Policy Board

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## **APPENDIX A**

### **SOURCES**

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DoD National Defense Budget Estimates for FY 2013 (Green Book) March 2012 - Table 3-1 & 3-2

[http://comptroller.defense.gov/defbudget/fy2013/FY13\\_Green\\_Book.pdf](http://comptroller.defense.gov/defbudget/fy2013/FY13_Green_Book.pdf)

DoD Defense Health Program FY 2013 Medical Workload Data

[http://comptroller.defense.gov/defbudget/fy2013/budget\\_justification/pdfs/09\\_Defense\\_Health\\_Program/VOL\\_I/Vol\\_I-Sec\\_7C\\_PB-11B\\_Medical\\_Workload\\_Summary\\_DHP\\_PB13.pdf](http://comptroller.defense.gov/defbudget/fy2013/budget_justification/pdfs/09_Defense_Health_Program/VOL_I/Vol_I-Sec_7C_PB-11B_Medical_Workload_Summary_DHP_PB13.pdf)

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[http://siadapp.dmdc.osd.mil/personnel/CASUALTY/gwot\\_component.pdf](http://siadapp.dmdc.osd.mil/personnel/CASUALTY/gwot_component.pdf)

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DoD Fiscal Year 2013 Budget Estimates - Military Construction - Family Housing - Defense-Wide

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DoD Procurement Programs – Reserve Components (P-1R) exhibit for FY 2013

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DoD Procurement Programs (P-1)

[http://comptroller.defense.gov/defbudget/fy2013/fy2013\\_p1.pdf](http://comptroller.defense.gov/defbudget/fy2013/fy2013_p1.pdf)

DoD Actuary- Statistical Report on the Military Retirement System for FY 10

<http://actuary.defense.gov/statbook10.pdf>

DoD Actuary- Healthcare Valuation Report September 30 2010 Table B2

<http://actuary.defense.gov/Portals/15/Documents/FY2010MERHCFValbook.pdf>

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[http://www.va.gov/budget/docs/summary/Fy2013\\_Volume\\_I-Summary\\_Volume.pdf](http://www.va.gov/budget/docs/summary/Fy2013_Volume_I-Summary_Volume.pdf)

US Department of Labor, FY 2013 Congressional Budget Justification - Veterans Employment and Training Service

<http://www.dol.gov/dol/budget/2013/PDF/CBJ-2013-V3-05.pdf>

US Department of Education IMPACT AID Fiscal Year 2013 Budget Request

<http://www2.ed.gov/about/overview/budget/budget13/justifications/c-impactaid.pdf>

US Office of Management and Budget, Budget FY 2013 - Other Defense - Civil Programs

<http://www.gpo.gov/fdsys/pkg/BUDGET-2013-APP/pdf/BUDGET-2013-APP-1-22.pdf>



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## **APPENDIX B**

### **SLIDES APPROVED BY RFPB ON 12 DECEMBER 2012**

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Reserve Forces Policy Board  
Cost Methodology Project Final Report

# **Eliminating Major Gaps in DoD Data on the Fully-Burdened and Life-Cycle Cost of Military Personnel**

*Cost Elements should be Mandated by Policy*

**As approved by RFPB – 12 December 2012**



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# The Problem



# The Problem

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- The Fully-burdened and Life-Cycle Cost trends supporting the All Volunteer Force are unsustainable.
- The Secretary of Defense, senior officials, and think tanks have all underscored this problem.
- DOD does not know, use or track the “Fully Burdened” and “Life Cycle” costs of military personnel in decision-making.
- Thus, major decisions are uninformed on the real costs.



# Unsustainable Cost Trends of the All Volunteer Force

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- The all-in DOD costs of “taking care of people” now consumes over 50% of the total DOD budget (More than \$250 Billion).
- Costs outside DOD are in excess of another \$200 Billion. (Programs within the Departments of Veterans Affairs, Labor, Education and Treasury)
- Currently, senior DOD officials do not know or calculate the “fully burdened” or “life cycle” costs of the All Volunteer Force.
  - Without knowing all of these costs, it is extremely difficult to address required changes or determine the proper force structure (active, civilian, contractor, or reserve component member).
- Both Secretaries of Defense Leon Panetta and Robert Gates expressed significant concern about the “unsustainability” of cost growth in the personnel and benefits area, including deferred compensation.
  - They both recommended reforms to the DOD healthcare system where costs have gone from \$20B a year to \$52B a year and (without reforms) are projected to rise to \$70B a year for the over 9 million beneficiaries (5.5 million retirees and their dependents).
  - Military Retirement is a concern as well, since it costs the taxpayers over \$100B a year for 2.4 million retirees.



# Secretary of Defense on Personnel Costs



Secretary of Defense  
Leon Panetta  
2011

“The fiscal reality facing us means that we also have to look at the growth in personnel costs, which are a major driver of budget growth and are, simply put, on an unsustainable course.”

“in order to build the force needed to defend the country under existing budget constraints, the escalating growth in personnel costs must be confronted. This is an area of the budget that has grown by nearly 90 percent since 2001.”

“growth in personnel costs must be addressed. If we fail to address it, then we won’t be able to afford the training and equipment our troops need in order to succeed on the battlefield.”



Former Secretary of Defense  
Robert Gates  
2010

“This department simply cannot risk continuing down the same path where our investment priorities, bureaucratic habits and lax attitudes toward costs are increasingly divorced from the real threats of today, the growing perils of tomorrow and the nation's grim financial outlook.”

“My hope and expectation is that as a result of these changes over time, what had been a culture of endless money where cost is rarely a consideration will become a culture of savings and restraint.”





# Fully Burdened Costs of the All Volunteer Force



## Senior Official Quotes

### Senior Official Views

- **Hon. Robert Hale, USD (Comptroller)** : "The cost of pay and benefits has risen more than 87 percent since 2001, 30 percent more than inflation."
- **Hon. Clifford Stanley, USD(Personnel & Readiness)** : Rising personnel costs could "dramatically affect the readiness of the department" by leaving less money to fund operations.
- **Gen. Ron Fogelman, former Chief of Staff, USAF**: "The all-volunteer force, as it exists today, for the size of the force, is just simply unaffordable."
- **Hon. Dennis McCarthy, former ASD (Reserve Affairs)**: "One of my main tasks...was to lead a "comprehensive review" of the Guard and Reserve. My main frustration...was that we couldn't get agreement on how to calculate the cost of personnel. We need an apples-to-apples methodology that accurately calculates the true cost of people in the AC and RC."



# Fully Burdened Costs of the All Volunteer Force

Analysis from the Policy Community



## Think Tank Views

- **Center for Strategic and Budgetary Assessment**, July 2012:
  - "Over the past decade, the cost per person in the active duty force increased by 46 percent."
  - "If personnel costs continue growing at that rate and the overall defense budget remains flat with inflation, military personnel costs will consume the entire defense budget by 2039."
- **Bipartisan Policy Center**, June 2012: DoD will soon spend more on health care and other benefits for former military personnel than on troops in uniform today.
- **Center for American Progress**, May 2012: "The all-volunteer force, in its current form, is unsustainable."
- **Congressional Budget Office**, 2012: Military compensation has outpaced inflation rates and private-sector wages by more than 25 percent the past decade.



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# **RFPB Philosophy and Approach**



# Project Philosophy

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## WHY

- Senior decision-makers do not know what the “fully burdened” and “life cycle” costs of military personnel are, and thus, are not able to track relevant trends, do accurate comparisons, or seriously address adverse cost trends.
- The current DoD directive (DTM 09-007), and the DoDI to replace it (DoDI 7041.dd), does NOT include all the relevant cost factors.
- There appears to be “resistance” to identifying all the costs and allocating them appropriately.

## WHAT THIS IS NOT

- An effort to argue for smaller AC forces or larger RC forces
- An effort to reform the pay, compensation, and benefits system
- An effort to challenge the rationale on the levels of the cash and non-cash elements currently supporting the All-Volunteer Force

## WHAT THIS IS

- An effort to provide an independent, objective method to develop and present **repeatable data** for “fully burdened” and “life cycle” costs of military personnel, to track these trends over time, and to permit objective comparative analysis.



# Secretary of Defense Charge to RFPB



On 5 September 2012, SECDEF met with the RFPB and asked us to provide advice and recommendations on four strategic topics:

- Best Ways to use the RC in the Future
- AC/RC Mix
- **Cost of a Strong Reserve**
- How to Achieve Savings in Reserve Components

Chairman established a Task Force led by the Hon. Grier Martin to draft recommendations in response to the Secretary of Defense.





# What the RFPB Study Seeks to Address

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Senior decision-makers do not know the full costs of active, guard or reserve forces, nor do they have an ability to track trends or do comparative analysis of costs when making crucial decisions.

- **Reason:** There is no permanent DoD-level policy on the subject. No process is in place to develop and update annual “Fully Burdened” or “Life Cycle” costs of individual military members for DoD Senior Leadership review.
- **Result:** Although individual cost studies have been conducted in the past, there is no DoD consensus or standardized process for use by all Services; they use different cost elements for AC/RC cost comparison and do not consider all costs.
- **Good News:** Temporary Directive-Type Memorandum (DTM) 09-007 provides a starting framework to move in the right direction. It includes many costing elements, but it does not provide the Services with all “Fully Burdened” and “Life Cycle” costing elements. Additionally, it does not include Reserve Component tables. The replacement DoD Instruction is being worked now by Cost Assessment Program Evaluation (CAPE) personnel, but it too lacks all costing elements and Reserve Component costing tables. This **shortfall could be rectified by issuing a new DoD policy on AC/RC Costing.**



# Project Approach

## Critical Considerations

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- Foundation for analysis is to identify costs at the individual level
  - Need to know individual costs to be able to calculate unit costs
  - Enable Apples-to-Apples comparisons
  - Seek common Business Case Analysis Processes across the Services and Components
  - Have DoD follow the same requirement they impose on contractors to allocate all costs
  - Ensure all stakeholders are included and heard
- Identify and capture 'lessons-learned' from previous analysis
- Identify all individual "Fully Burdened" and "Life Cycle" costs
  - Identify all cost elements to include those covered by other agencies (Treasury, Education, VA, etc.)
  - Determine which are appropriate for consideration by DOD decision-makers
- Address Policy Concerns
  - Should DOD have an instruction in place to guide the Services on how to account for all "Fully Burdened" and "Life Cycle" costs with standardized accounting since today this does not exist?
  - What DoD organization should be required to institutionalize this analysis, formalize the process, and track and compare trends over time?





# DOD Requires “Fully Burdened” and “Life Cycle” Costing in Other Areas

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- DoD and Congress requires “all” costs to be included and considered in major acquisition decisions.
  - Mere “fly away” cost is deemed inadequate. DoD uses program acquisition unit cost and provides “life cycle” operating costs.
- DoD now uses “Fully Burdened Cost of Energy” (FBCE) calculations to assess long-term fuel costs in procurement decisions.
- **A similar approach should inform decisions about military personnel where the “all in” costs are just as significant.**





# DoD Requires Contractors to Invoice the “Fully Burdened” Cost of Personnel



Direct/Contract Labor	\$ 85,000
Other Direct Costs (ODC's)	\$ 1,500
Fringe @ 30%	\$ 25,500
Overhead @ 65%	\$ 55,250
Subtotal	\$ 167,250
G&A at 5%	\$ 8,363
Total Contract Costs	\$ 175,613
Fee @ 8%	\$ 14,049
Total Price	\$ 189,662
Wrap Rate	2.23

- **Wrap Rate**: The ratio of direct to total labor cost. Based on a fully-burdened labor rate at which a business, such as a consultancy, must bill out its direct labor units in order to cover its direct and indirect costs - wages, benefits, facilities, overhead, general and administrative costs, deferred compensation and the fee.
- DoD should apply the same standard to its own internal costing.

Notes:  
The “Fully Burdened” Total Contract Cost is more than 106% higher than the paycheck cost.  
Fringe applied on direct/contract labor base  
Overhead applied on direct/contract labor base  
G&A (General & Administrative) applied on costs through overhead (i.e. direct/contract labor, fringe, overhead, other direct costs)



# Project Approach

## Build a “Layer Cake” from the Bottom Up

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### A “Layer Cake” approach to ensure stakeholders are informed and heard

- Layer 1: Identify/Develop “Fully Burdened” and “Life Cycle” individual cost elements, alternatives, and recommendations
  - Review Previous Costing Studies
  - Gather Service/Reserve Component cost experts to compare current approaches & identify cost elements.
  - Quantify/refine cost elements by analysis of FY13 Budget Request
  - Draft recommendations
- Layer 2: Military Service vetting
- Layer 3: Office of the Secretary of Defense vetting
- Layer 4: Subject Matter Expert vetting, both internal and external

**Report findings to Secretary of Defense following RFPB deliberations**



# Inconsistent Use of Cost Elements in Military Personnel Cost Analyses in DoD



- The RFPB project team convened 16 meetings of an informal working group of costing experts from across the Department in order to examine and compare current military personnel costing practices across Services and Components.
- Found that military personnel costing is neither complete nor consistent.

## Cost Elements Used by Most Components

Basic Pay
Basic Allowance for Housing (BAH)
Basic Allowance for Subsistence (BAS)
Incentive Pays
Special Pays
Allowance - Uniform Clothing
Allowance - Station Allowance Overseas
Allowance - CONUS COLA
Subsistence in Kind
Family Subsistence Supplemental Allowance
Social Security and Medicare (Employer's Contribution)
Permanent Change of Station - All but Separation Travel
Retired Pay Accrual
Separation Payments
Education Assistance (e.g., portion of GI Bill)
Other Military Personnel Cost - Unemployment
Other Military Personnel Cost - Death Gratuities
Other Military Personnel Cost - Survivor Benefits
Other Military Personnel Cost - Other
Medicare -Elig Retiree Health Care Fund (MERHCF)

**~ \$130 Billion in FY 2013**

## Cost Elements with Wide Variance in Use

Allowance - Family Separation
Allowance - Personal Money Allowance, Gen & Flag Offs
Permanent Change of Station - Separation Travel
Other Military Personnel Cost - Adoption
Other Military Personnel Cost - Partial Dislocation
Other Military Personnel Cost - Transport Subsidies
Family Housing Construction & Operation
Military Construction
Health Care
Discount Groceries / Commissary Cost
Child Day Care Facilities
Training
Recruitment Advertising, Etc.
DoDEA and Family Assistance
Child Education (Dept of Education Impact Aid)
Operations & Maintenance
Procurement

**~ \$315 Billion in FY 2013**

## Cost Elements Not Used

Veteran's Employment and Training
Treasury Contribution to Retirement
Treasury Contribution for Concurrent Receipt
Treasury Contribution to MERHCF
Treasury Contribution to Survivor Benefits
Veteran's Benefits (Cash and In-Kind)
DoD Research Development Test & Evaluation

**~ \$290 Billion in FY 2013**



# Why it matters

## FY 2013 Fully-Burdened Per-Capita Cost to the US Government

**Omitting these costs ignores about 20% of compensation**



### Military Personnel Account Costs\*

DoD Defense Health Program

DoD Dependent Education

DoD & Service Family Housing

DoD Commissary Agency

### **TOTAL DoD Compensation Costs**

O&M (Less DoD Dependent Education)

Procurement

Military Construction

RDTE & Other

### **TOTAL DoD Non-Compensation Costs**

Dept of Defense Grand Total

Dept of Education "Impact Aid"

Dept of Treas - Concurrent Receipt

Dept of Treas - MERHCF

Dept of Treas - Mil Retirement

Dept of Veteran Affairs

Dept of Labor for Vet Education / Training

### **TOTAL COST TO US GOVERNMENT**

Active Component	Reserve Component
\$ 84,808	\$ 26,033
\$ 19,233	\$ 8,157
\$ 2,034	\$ 33
\$ 1,235	\$ -
\$ 996	\$ 49
<b>\$ 108,307</b>	<b>\$ 34,272</b>

\$ 110,532	\$ 26,477
\$ 71,601	\$ 3,771
\$ 5,556	\$ 1,512
\$ 34,348	\$ 34,348
<b>\$ 222,037</b>	<b>\$ 66,108</b>

\$ 330,343	\$ 100,380
\$ 355	\$ 9
\$ 4,514	\$ 747
\$ 3,264	\$ 2,230
\$ 39,800	\$ 13,638
\$ 6,334	\$ 6,334
\$ 12	\$ 12
<b>\$ 384,622</b>	<b>\$ 123,351</b>

\* Includes DoD contributions to MERHCF and Military Retirement Accrual



# Reserves Have Significantly Less Overhead and Infrastructure Costs



The 837,400 RC members are **39%** of the 2.2 million-member Total Force but account for...

- **26%** of Medicare-Eligible Retiree Health Fund Contribution
- **26%** of Military retirees drawing pay
- **21%** of Defense Health Program costs
- **17%** of Retirement Payout costs
- **16%** of Military Personnel costs
- **15%** of Military Construction costs
- **13%** of Operation & Maintenance
- **9%** of Concurrent Receipt of disability and retirement costs
- **3%** of Commissary users
- **3%** of Procurement costs
- **1%** of DoD Dependent Education costs
- **0%** of Family Housing costs

SOURCES: FY 2013 Base Budget Request funding and end strength for active components and the selected reserves; survey data from Defense Commissary Agency, DMDC statistics on military retirees, analysis of FY2013 Treasury Budget documents.



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# **RFPB Recommendations**



# RFPB Interim Recommendations

## Interim Report to SECDEF - June 2012

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- Director of Cost Assessment and Program Evaluation (CAPE) should establish permanent DoD policy (DoD Instruction) that covers “Fully Burdened” and “Life Cycle” costs for individual military members of both the active and reserve components and report these costs in an appropriate annual report
  - Ensure current draft DoD Instruction 7041.01 includes RC Costing tables (RC costing tables should be informed by RFPB analysis)
  - Extend and revise DTM 09-007 until RC costing data is included or issue other interim AC/RC cost comparison guidance to support near-term AC/RC mix decision-making
  - Standardize costing elements across Services
  - Provide DoD Senior Leadership with costing data to track cost trends and utilize them in comparative analysis
  - Goal - capture “fully burdened” and “life cycle” costs to DoD and to Federal Government and ensure outside independent agencies verify these costs to include GAO and CBO
- Comptroller should update current DoD Financial Management Regulation (FMR) (DoD 7000.14R), Volume 11A, Chapter 6, Appendix I, to include guidance to develop Military Composite Standard Pay and Reimbursement rate tables for the Reserve Components



# Summary of Recommendations

The Secretary of Defense should...

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1. Establish DoD policy/guidance for computing fully-burdened Military Personnel Cost for the Total Force
2. Specify all the cost elements that must be included in cost studies
3. Identify mission support, Treasury contributions, and all other external costs that must be considered
4. Calculate and report cost element figures annually
5. Clarify the use of composite rates in studies
6. Develop a model to calculate and compare life-cycle costs





## Recommendation #1



# Establish DoD policy for Total Force Personnel Costing

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**Director of Cost Assessment and Program Evaluation (CAPE) should establish permanent DoD policy for calculating the “Fully Burdened” costs for individual members of both active and reserve components.**

- In its “Interim Report” of April 2012, RFPB recommended that such a policy be established.
- CAPE leadership agrees with need to draft such a policy.
- Details of the content of policy, annual calculation and “Life Cycle” costs are addressed in the RFPB recommendations which follow.



## Recommendation #2

# **Specify Cost Elements for Inclusion in Total Force Personnel Cost Studies**

**DoD Policy should require that any study conducted or contracted by the Services or other DoD component for the purpose of comparing the costs of active and reserve component personnel or forces include, at a minimum, the following cost factors:**

- Personnel Account Costs
  - Basic Pay
  - Retired Pay Accrual
  - Allowances, Incentives & Special Pay
  - PCS Costs
  - Medicare-Eligible Retiree Health Fund Contribution
- DoD Healthcare Costs
- DoD & Dept. Ed. Dependent Education Costs
- DoD & Service Family Housing Costs
- DoD Commissary Costs
- Treasury Contribution for Concurrent Receipt
- Base Operations Support Costs



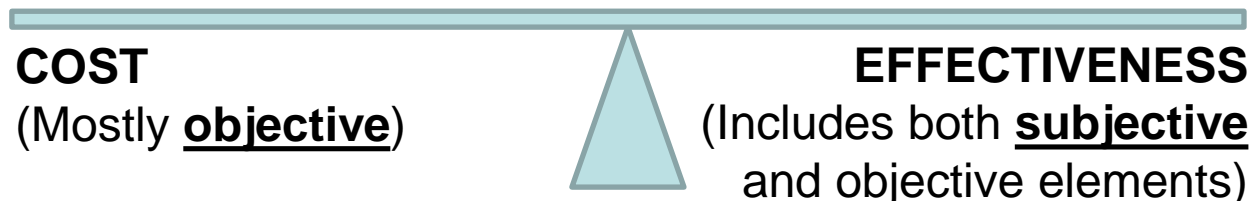
# Cost and Non-Cost Factors in Force Structure Decisions



- Cost should not be the sole basis for determining force structure and the mix of active, reserve, defense civilian and contractor personnel.
- Other key factors include requirements, capability, capacity, risk and expectations of future demand such as:
  - Frequency
  - Duration
  - Speed of response
  - Readiness levels for given mission sets

These factors often require subjective calls based on professional military judgments.

To support such decision-making it is essential that DoD's cost-estimating methodology – the objective side of the equation – be as complete and consistent as possible.





# Military Personnel Account Costs

- Composite Rate calculation in DoD Financial Management Regulation includes key minimum cost elements:
  - Basic Pay
  - Retired Pay Accrual
  - Allowances, Incentives, Special Pays
  - PCS Cost
  - Miscellaneous Expense
  - Medicare-Eligible Retiree Health Care (MERHC) Accrual
- FY'13 average Retired Pay Accrual: \$20.8 Billion.
  - \$12,834 per AC service member
  - \$ 3,419 per RC service member
- FY'13 PCS cost: \$ 4.9 Billion. (\$ 3,260 per AC service member)
- All of these elements are necessary – but not sufficient on their own – to fully capture the cost of personnel as these elements account for less than half of the total cost.

**Military Personnel Costs must be fully included in future cost studies**



# DoD Health Care Costs

- FY'13 Defense Health Program: **\$32.5 Billion**
  - Plus \$8 Billion in Medical Personnel & \$7 Billion for MERHCF
- Serves more than **9.5 million beneficiaries**
  - Service members (1.7 million people)
  - Retirees (2.1 million people)
  - Family Members & Survivors (5.7 million people)
    - Active: 2.4 million / Retiree: 2.9 million / Survivors: .4 million
  - Approximately 26% of beneficiaries are Reserve Component
- RC uses the system less than AC & active retirees
- Current DoD estimate for per capita Active Duty health cost of \$10,563 excludes cost of health care for under-65, non-Medicare-eligible retirees. This cost should be captured and attributed.

**DoD Health Care Costs must be fully included in future cost studies**



# DoD & Department of Education Dependent Education Costs

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- FY'13 DoD Education Activity: **\$2.7 Billion**
- FY'13 Department of Education military "Impact Aid": \$505 million
- Reservists generally do not send dependent children to DoD schools
- Only reservists serving on active duty are counted for Impact Aid calculations
- RFPB staff estimates that RC accounts only for about 1% of DODEA costs

**DoD and Dept of Education Costs for dependent education  
must be fully included in future cost studies**



# DoD & Service Family Housing Costs

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- FY'13 Total to build and operate: **\$1.65 Billion**
- Almost exclusively used by Active Component Personnel
- Reservists, not on active duty, do not qualify for on-base housing
- Few Reservists on active duty use on-base family housing

**DoD and Service cost for building and operating  
must be fully included in future cost studies**



# DoD Commissary Costs

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- FY'13 Cost to Operate over and above revenue income: **\$1.37 Billion**
- Only 3% of Commissary users are Reserve Component according to DoD Commissary Agency survey data.
  - Consistent with Food Marketing Institute study (May 2000) which estimated that 5% of commissary users were RC.
- The average American lives less than 6 miles from a supermarket.
- In contrast, 54% of RC units are located more than 20 miles away from a military commissary.

**DoD Commissary Costs must be fully included in future cost studies**





# Base Operations Support Costs

- FY'13 BOS for DoD: \$ **36 Billion**
  - Less than 12% is Reserve Component
  - AC: \$ 32 Billion. RC: \$ 4 Billion.
- Base Operations Support costs should be required to be included in cost studies.
  - Facilities Sustainment, Restoration, and Modernization (SRM)
  - Security and utilities
  - Base food service, transportation and communications
  - MWR Facilities
  - Chapels
  - Day care centers
  - DoD Dependent Schools
  - Family Housing
  - Barracks

**Appropriate DoD and Service O&M Costs must be included in future cost studies**



## Recommendation #3

### Identify Other Costs that must be Considered

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**DoD Policy should require that any study comparing the costs of active and reserve component personnel or forces consider the amounts, degree and methodology for possible inclusion of all or part of the annual contributions made by the US Treasury, Veterans costs, and the non-compensation costs of the Department of Defense.**

- Complexity of Treasury Contributions requires expert study to determine which parts are attributable to active or reserve component force decisions
- Non-Compensation Costs such as O&M, Procurement, Military Construction and RDT&E will vary across Services, but still merit explicit DoD guidance for inclusion in future cost studies.



# U.S. Treasury Contributions

- Concurrent Receipt of both Retired Pay and Veterans Disability
  - **\$ 6.95 Billion** in FY 13
  - Only about **9%** is attributable to Reserve recipients
- Medicare-Eligible Retiree Health Care Fund (MERHCF)
  - **\$6.44 Billion** in FY 13
  - Only about **29%** of actuarial liability is Reserve
- Military Retirement Fund
  - **\$ 67.18 Billion** in FY 13
  - Only about **17%** of payout is made to Reserve retirees
- While the Treasury contribution for Concurrent Receipt is a cost element that should be included in future cost studies, the other contributions should be considered. They involve unfunded liabilities due to existing retirees. Thus, an accurate attribution of such costs in force mix decisions requires more study.

**Treasury Contributions for Concurrent Receipt should be included in cost studies. Others require further study.**



# Other DoD & Federal Costs

- These additional costs should be required to be considered in cost studies
  - DoD & Service Non-Compensation Costs
    - **Operations & Maintenance** (other than parts already required per recommendation #2)
    - **Procurement**
    - **Military Construction**
    - **RDT&E & Other** (e.g. Environmental Restoration, Drug Interdiction, BRAC, etc.)
  - Veterans Costs (Dept. of Veterans Affairs & Dept. of Labor)

**Other DoD & Federal costs should be required to be considered in future Military Personnel cost studies**



## Recommendation #4

### **Calculate and Report All Cost Elements Annually**

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**The Director, Cost Assessment and Program Evaluation (CAPE) or the Under Secretary of Defense (Comptroller) should calculate and publish all cost elements for Total Force military personnel cost studies on an annual basis, and provide guidance on their use in an appropriate memo or report.**

- Will provide updated and consistent numbers for the Services and other DoD components to use in costing studies.
- Demonstrates DoD commitment to tracking costs in an increasingly budget-constrained environment



## Recommendation #5

### Clarify Use of Composite Rates in Studies

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**The Under Secretary of Defense (Comptroller) should modify the annual memo on “Military Personnel Composite Standard Pay and Reimbursement Rates” to eliminate the directive to use such rates “when determining the cost of military personnel for budget/management studies.”**

- DTM 09-007 correctly states:
  - “The DoD composite rates... do not account for the full costs of military personnel”
  - “For this reason, composite rates should not be the only source of data used when answering questions about the cost of the defense workforce, making workforce-mix decisions, or determining the cost impact of manpower conversions.”
- If the Composite Rates are intended narrowly to be used to calculate the labor cost for the preparation of documents such as reports, studies or budget submissions, the annual memo should say this more clearly.



## Recommendation #6

### Develop a model to calculate and compare “life-cycle” costs

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**The Director, Cost Assessment and Program Evaluation (CAPE) should develop a model to calculate and compare the “life cycle” costs to the federal government of active and reserve component personnel.**

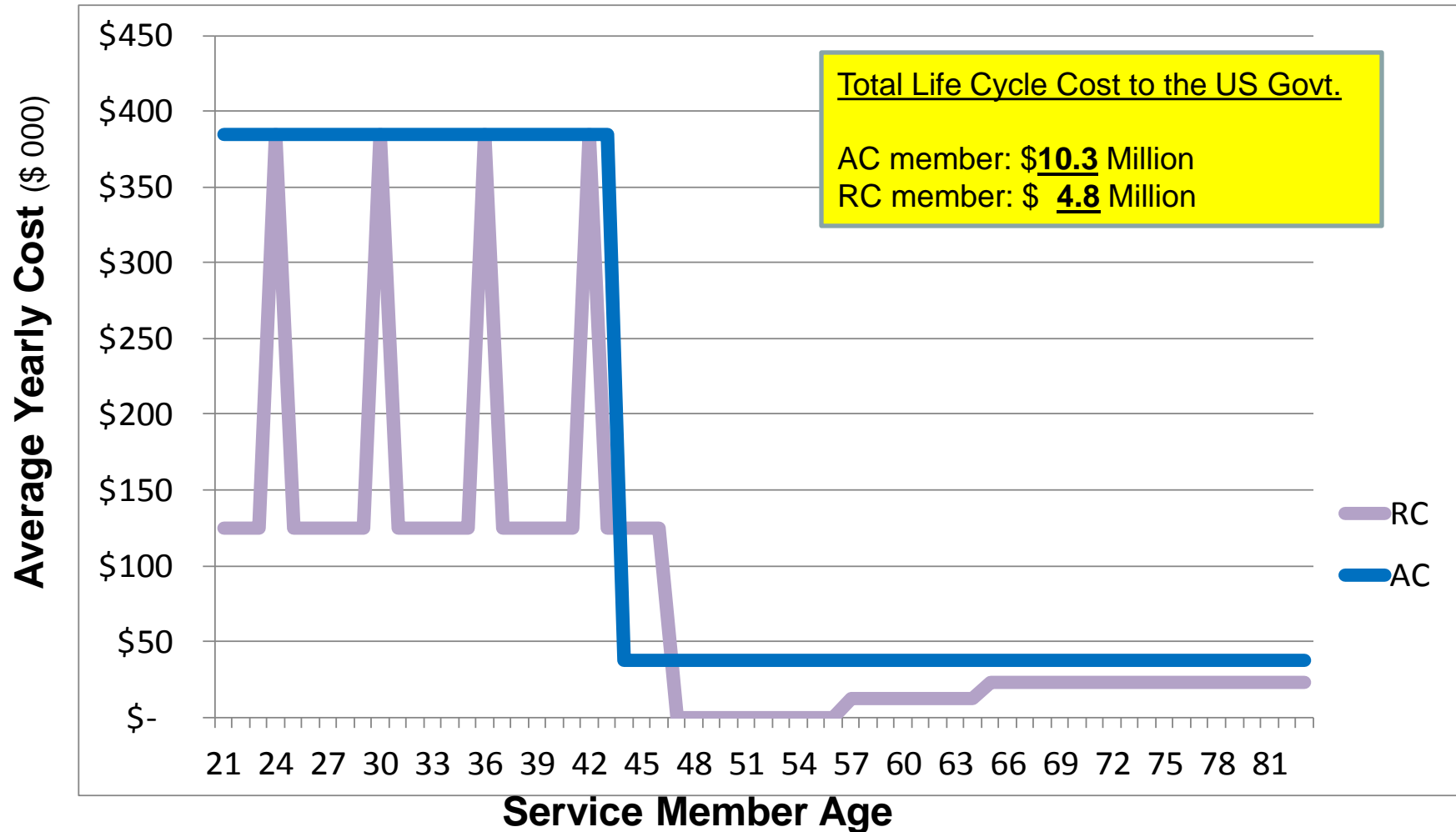
- **DoD Model Development should include study of two key examples:**
  - “Cost of the Reserve Components” by Jennifer Buck, 2008
  - Air Forces Reserve’s “Individual Cost Assessment Model” (ICAM)
- **Long-term Costs of Active and Reserve Component forces are very different.**
  - RC Retirement is paid at a lower amount for a shorter period of time
  - RC Retiree Health Care costs are much lower than AC Retirees
  - “The DoD composite rates... do not account for the full costs of military personnel”
- **Leveraging previous “life-cycle” cost methodologies suggests that:**
  - The life-cycle cost of RC service member is less than half that of AC counterpart.



# Notional AC/RC

## Fully Burdened / Life Cycle

### Cost Illustration based on work by Jennifer Buck



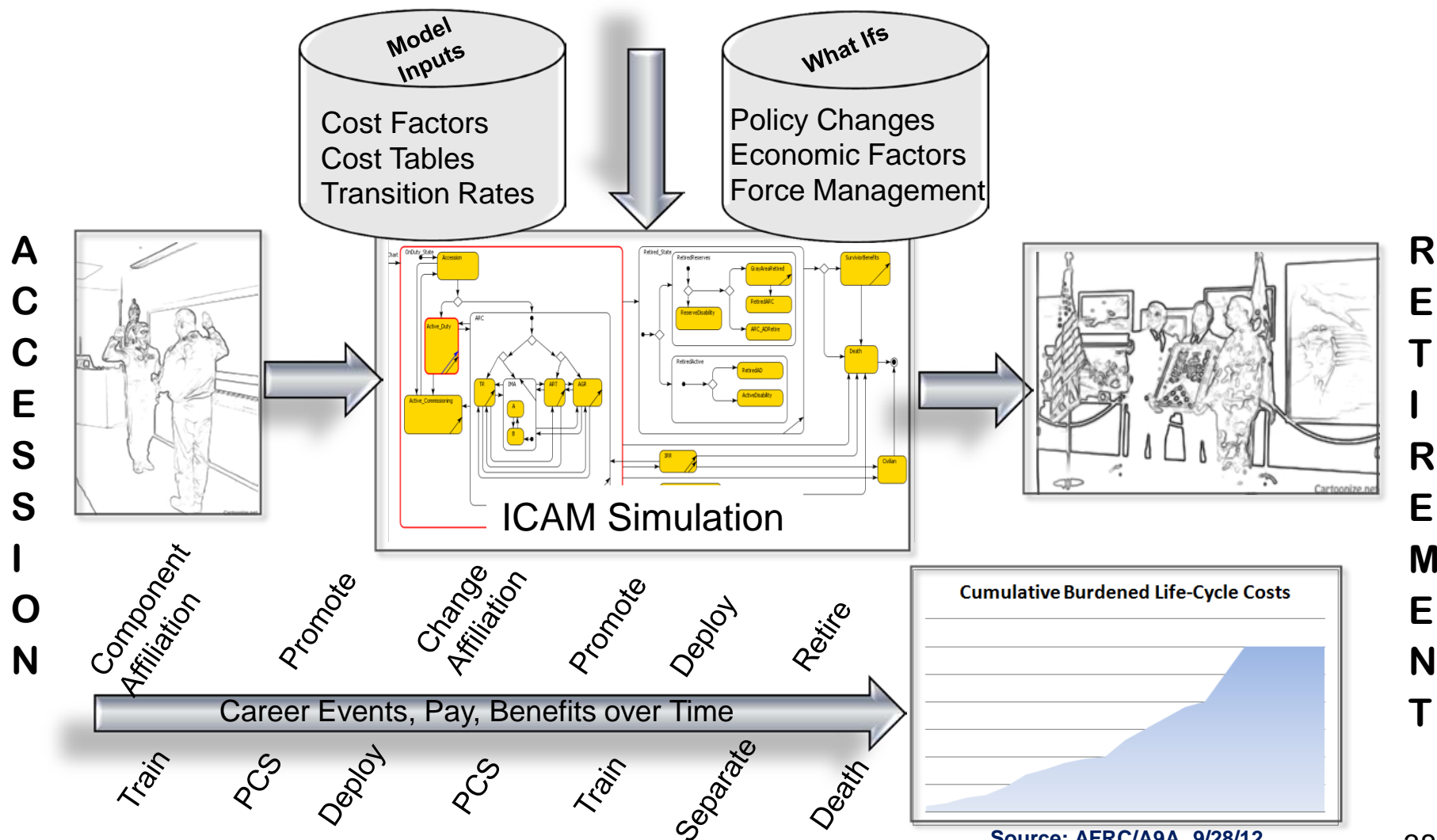




# US Air Force Reserve's

## “Individual Cost Assessment Model”

An exemplary “Life-Cycle” costing tool DoD should study





# AC/RC Retiree Pay Illustration

## Total Cost Differences after 20-year Career

(Extrapolated based on FY2010 data, not discounted for accruals, not inflated)

### Non-Disabled Military Retirees Retired

	Monthly Pay (Avg. Gross)	Age at Retirement*	Years to Life Expectancy	Total Retirement Pay	Percent of AC
AC O-5	\$4,356	43	40.5	\$2,117,016	29%
RC O-5	\$2,074	60	24.8	\$617,222	
AC E-7	\$2,088	40	38.8	\$972,173	26%
RC E-7**	\$1,005	60	21	\$253,260	

\*Longevity is based on military specific tables that assume an entry age of 23 for commissioned officers and warrant officers and an entry age of 20 for enlisted members.

\*\* Average enlisted AC service member retires at E-7 while the average RC service member retires as an E-6 at a lifetime cost of \$173,376.

The RC officer draws less than 1/2 the monthly pay for less than 2/3 the duration.

The RC enlisted member draws less than 1/2 the monthly pay for almost 1/2 the duration.

Source: DoD Office of the Actuary. (May 2011). *Statistical Report on the Military Retirement System Fiscal Year 2010*.



# AC/RC Retiree Health Cost Illustration

## Total Cost Differences after 20-year Career

(Extrapolated based on FY2010 data, not discounted for accruals, not inflated)

### Defense Health Program Beneficiaries

Active Duty	1,682,908
Active Duty Family Members	2,377,162
CHAMPUS Retirees	1,066,430
CHAMPUS Family Members	2,261,027
Medicare-Active Duty Family	8,241
Medicare-Guard/Reserve Family members	2,318
Medicare-Retirees	1,039,209
Medicare-Retiree Family Members	673,757
Medicare-Inactive Guard/Reserve	14
Medicare-Survivors	462,586
Medicare-other	1,957
<b>TOTAL Beneficiaries</b>	<b>9,575,609</b>

### Defense Health Program Costs

DHP O&M, RDTE & Procurement	\$	32.5	B
MERHFC Contributions	\$	6.7	B
DHP Mil Personnel	\$	8.4	B
DHP MilCon	\$	1.0	B
<b>Total Health Care Costs</b>	<b>\$</b>	<b>48.6</b>	<b>B</b>

**Cost Per Beneficiary** \$ 5,082

**Cost Per CHAMPUS Retiree**  
(age <65) + 2.12 Dependents \$ 15,857

**Cost Per MEDICARE-Eligible Retiree**  
(age 65+) + 0.65 Dependents \$ 8,377

### Comparative AC/RC Retiree "Life Cycle" Healthcare Costs

		Age at Retirement	Years to Life Expectancy	Years at \$15,587 CHAMPUS Rate	Years at \$8,377 Medicare-Eligible Rate	Health Care Cost TOTAL
AC	O-5	43	40.5	21	19.5	\$496,349
RC	O-5	60	24.8	4	20.8	\$237,670
AC	E-7	40	38.8	24	14.8	\$504,548
RC	E-7	60	21	4	17	\$205,837

**Younger AC retirees have more dependents and use the health care system longer**

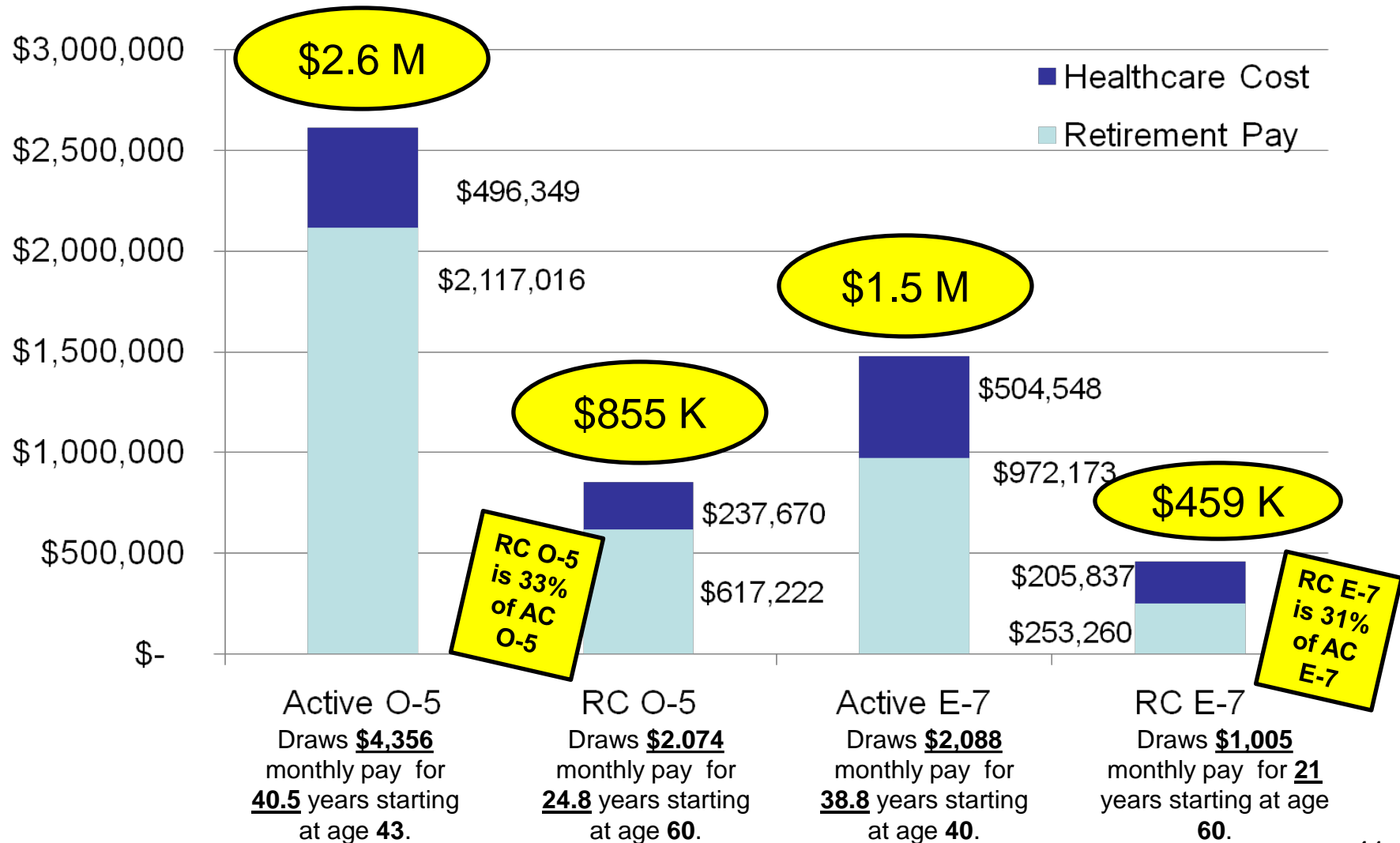
Sources: Defense Health Program Fiscal Year 2013 Budget Estimates – Appropriation Highlights and Medical Workload Data. DoD Office of the Actuary. (May 2011). *Statistical Report on the Military Retirement System Fiscal Year 2010*

**RC Retiree's Total Healthcare cost is less than half that of AC Retiree**



# AC & RC Retiree Total Cost of Pay and Healthcare to Life Expectancy

(Extrapolated based on FY2010 data, not discounted for accruals, not inflated)





# Questions?

Maj Gen Jimmy Stewart, USAFR  
Military Executive, Reserve Forces Policy Board



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# APPENDIX SLIDES

## (BACK-UPS)



# The FY'13 Federal Budget Request

<b><u>The DoD Budget</u></b>	<b><u>\$ Billions</u></b>
O&M (less DODEA & DeCA)	\$169.8
Military Personnel	\$135.1
Procurement	\$98.8
RDTE & Other	\$74.7
Defense Health Program	\$32.5
Military Construction	\$8.7
DoD Dependent Education (DODEA)	\$2.7
Family Housing (Construction & Ops)	\$1.7
Defense Commissary Agency (DeCA)	<u>\$1.4</u>
<b>DOD TOTAL</b>	<b>\$525.4</b>
<b><u>Other Federal Agencies</u></b>	
Dept of Veteran Affairs (Total Budget)	\$140.3
Dept of Labor (Veteran Ed & Tng Svc)	\$0.3
Dept of Education (Impact Aid)	\$0.5
Dept of Treasury (Concurrent Receipt)	\$7.0
Dept of Treasury (MERHCF)	\$6.4
Dept of Treasury (Military Retirement Fund)	<u>\$67.2</u>
<b>OTHER FEDERAL AGENCY TOTAL</b>	<b>\$221.7</b>



# AC & RC Total and Per Capita Cost to DoD

## Based on FY13 DoD Base Budget Request (Green Book)



(\$ Million)	DOD TOTAL	ACTIVE COMPONENT ACCOUNTS					TOTAL AC	RESERVE COMPONENT ACCOUNTS						TOTAL RC	RC% of DOD Total
		Def-Wide	Army	Navy	USMC	USAF		USAR	USNR	USMCR	USAFR	ARNG	ANG		
Military Personnel	135,112		42,624	28,274	13,155	29,260	113,312	4,942	2,040	746	1,885	8,850	3,337	21,800	16%
O&M (less DODDEA)	169,854	29,248	36,609	41,607	5,983	35,435	148,882	3,162	1,247	272	3,167	7,109	6,016	20,972	13%
Military Construction	8,690	3,655	1,923	1,702		388	7,668	306	50		11	614	42	1,022	15%
Family Housing	1,651	54	535	480		582	1,651	0	0	0	0	0	0	0	0%
OMDW RC Adjustment							-1,200							1,200	
MILCON DW RC Adj.							-244							244	
Defense Health Program	32,529						25,698							6,831	21%
DoD Dependent Ed	2,745						2,718							27	1%
DoD Commissary Agency	1,372						1,330							41	3%
<b>TOTAL</b>	<b>\$ 351,952</b>						<b>\$ 299,814</b>							<b>\$ 52,138</b>	<b>15%</b>
Procurement	98,823	4,377	15,884	40,636	1,604	33,166	95,666	660	120	19	332	1,710	317	3,158	3%
<b>TOTAL w/Procurement</b>	<b>\$ 450,776</b>						<b>\$ 395,480</b>							<b>\$ 55,296</b>	<b>12%</b>
RDTE & Other	74,654						45,892							28,763	39%
<b>TOTAL DOD Appropriation</b>	<b>\$ 525,430</b>						<b>\$ 441,372</b>							<b>\$ 84,058</b>	<b>16%</b>
End Strength Base Budget 2013		502,400	322,700	182,100	328,900	1,336,100		205,000	62,500	39,600	70,500	358,200	101,600	837,400	39%
% of DoD Budget Allocated								AC/RC		RC/AC					
Cost (\$) - Per Capita		67%					\$ 224,395			3.6	28%			\$ 62,262	
Cost (\$) - Per Capita with Procurement		86%					\$ 295,996			4.5	22%			\$ 66,033	
Cost (\$) - Per Capita with Every DoD Cost Allocated		100%					\$ 330,343			3.3	30%			\$ 100,380	





# Recent and Ongoing Cost Studies



Date	Org	Title	Finding
May 2007	RAND/OSD-RA	Unpublished study reported to CNGR	NG BCT costs 28% of AC (not deployed) and 136% in a 1:5 rotation
May 2007	OUSD-C	Testimony to CNGR	RC Service member costs 28-29% of AC member
June 2007	GAO	Estimate of Total Compensation	RC annual compensation (\$19k) is 15% of AC (\$126k)
Jan 2008	CNGR	Transforming the National Guard and Reserves into a 21 <sup>st</sup> Century Operational Force	RC per capita costs 23% of AC
2008	Falcon Books	"The Cost of the Reserves" by J. Buck in <i>The New Guard and Reserve</i>	RC member costs 58% of AC per deployment in life cycle model
April 2011	OSD-RA	Comprehensive Review of the Future Role of the Reserve Component	DoD needs a common costing methodology for the Total Force
2011	RAND	<i>Reshaping the Army's Active and Reserve Components</i>	RC BCT cost savings unlikely
Ongoing	OSD-CAPE	AC & RC Unit Costs per NDAA 2012	TBD
Ongoing	IDA / OSD-RA	<i>Analyzing the Costs of Alternative Army Active/Reserve Force Mixes</i>	RC provides a more affordable force structure
Ongoing	RAND	<i>Air Force Active/Reserve Mix</i>	AC cost-per-flying-hour generally lower than RC
Ongoing	RAND	<i>Reassessing the Army AC/RC Force Mix</i>	Army RC unit averages 29% of AC. Current policy / usage requires 2 RC units to match 1 AC unit capacity.



# Notional AC/RC Fully Burdened / Life Cycle Cost Illustration Assumptions

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- 20-year period of demand for 1:3 AC & 1:5 RC rotations
- AC annual cost: \$385 K
- RC annual cost: \$125 K
- RC costs same as AC for each of four mobilization/deployment years
- Career length: AC=22 years, RC=25 years
- Deployments completed: AC=7, RC=4
- AC retiree costs: \$27 K in retired pay, \$10K in DoD-provided healthcare
- RC retiree draws no retired pay until age 57 (age 60 minus 36 months credit for 4 x 9-month deployments)
- RC retiree costs: \$13 K in retired pay. At age 65 add \$10 K in healthcare (Medicare)
- Life Expectancy for both: Age 83



# Selected Officials & Experts Consulted

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- USD (P&R)
- USD (C)
- Director, CAPE
- CSA
- VCSAF
- ASD(RA)
- ASA (M&RA)
- ASN (M&RA)
- SAF/MR
- Chief, NGB
- Director, ARNG
- Chief, USAR
- Commander, Marine Forces Res.
- Chief, USNR
- Director, ANG
- Chief, USAFR
- ACJCS/NG&RM
- Deputy Director, Joint Staff J8
- Deputy Director, DOD Office of the Actuary
- Government Accountability Office
- Congressional Budget Office
- Center for Strategic & Budgetary Assessments
- Dr. John Winkler, RAND
- Ms. Jennifer Buck, Former Director Resources, OASD-RA

More than **100** meetings with senior officials and experts inside and outside the Department of Defense.